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PRIVATELY-FINANCED INFRASTRUCTURE PROJECTS*

Draft chapters of a legislative guide on privately-financed infrastructure projects

Report of the Secretary-General

1. At its twenty-ninth session, in 1996, the Commission decided to prepare a legislative guide on build-operate-transfer (BOT) and related types of projects.[1] The Commission reached its decision after consideration of a report prepared by the Secretary-General which contained information on work being undertaken by other organizations in that field, as well as an outline

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* The Commission may wish henceforth to use the words "privately-financed infrastructure projects" to refer to its work in this field, rather than the words "build-operate-transfer" (BOT), which had so far been used. Although sometimes used as a generic expression for different forms of private financing of public infrastructure projects, in its literal meaning "BOT" refers only to one particular type of infrastructure project with private funding. However, as the practice in this field continues to evolve, various different types of arrangements are developed which do not fall under the pure "BOT" category, such as "build-own-operate" (BOO), "build-own-operate-transfer"(BOOT), "build-own-lease-transfer" (BOLT) or "build-rent-transfer" (BRT), to name but a few. The proposed words are intended to make it clear that the Commission's work in this field covers all arrangements for the development of public infrastructure projects involving private financing, including, but not limited to, BOT arrangements.

[1] Report of the United Nations Commission on International Trade Law on the work of its twenty-ninth session, *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17), paras. 225-230.

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of issues covered by national laws concerning those arrangements.[2]

2. It was reported that, unlike publicly-funded projects, in which the Government is responsible for the entire implementation of the project, including for obtaining financing and guaranteeing its repayment, in the case of privately-financed infrastructure projects the Government engages a private entity to develop, maintain and operate an infrastructure facility in exchange for the right to charge a price, either to the public or to the Government, for the use of the facility or the services or goods it generates.

3. In its deliberations, the Commission noted the interest that BOT and other forms of private participation in public infrastructure projects had raised in many States, in particular in developing countries, as the successful implementation of such projects would enable States to achieve significant savings in public expenditure and to re-allocate resources that otherwise would have been invested in infrastructure in order to meet more pressing social needs. Furthermore, since the project is built and, during the concession period, operated by the project company, the country benefits from private sector expertise in operating and managing the relevant infrastructure facility. The Government may expect in particular to achieve efficiency gains and high standards of service, which sometimes may not be provided by self-regulated State monopolies.

4. It was noted, however, that BOT and similar projects could be quite complex and that their implementation required a favourable legal framework that fostered the confidence of potential investors, national and foreign, while protecting public interests. Thus, the Commission considered that it would be useful to provide legislative guidance to States preparing or modernizing legislation relevant to those projects. Pursuant to a request by the Commission, the Secretariat has reviewed issues suitable for being dealt with in a legislative guide and has prepared draft materials for consideration by the Commission, which are submitted with this report.

5. The document contained in annex I to this report contains a table of contents setting out the topics proposed to be covered by the legislative guide, which are followed by annotations in some detail concerning the issues suggested to be discussed therein. Those annotations are offered for the purpose of enabling the Commission to make an informed decision on the proposed structure of the legislative guide and its contents. In preparing that document, the Secretariat considered a number of issues which have often been addressed in national laws and regulations pertaining to privately-financed infrastructure projects. However, it is not suggested that the legislative guide should recommend that all of those issues be dealt with at the legislative level, and it is proposed to consider in the legislative guide the desirability of dealing with some of them in legislation, while leaving others to be addressed by the parties in the agreements concerning the implementation of the project.

6. For the purpose of providing the Commission with a clear view of the style and level of

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[2] Document A/CN.9/424.

detail envisaged for the legislative guide, the Secretariat has also prepared initial drafts of chapter I, "Scope, purpose and terminology of the Guide", chapter II, "Parties and phases of privately-financed infrastructure projects" and chapter V, "Preparatory measures" (Addenda 1 to 3 to this document)

7. In preparing the draft materials, the Secretariat has borne in mind the need to keep the appropriate balance between the objective of attracting private investment for infrastructure projects and the protection of the interests of the host Government and the users of the infrastructure facility.

8. The Commission may wish to provide comments on the proposed structure of the legislative guide and guidance on the issues suggested to be discussed therein, so as to allow the Secretariat to prepare the remaining draft chapters of the legislative guide for the next session of the Commission, in 1998.

Annex I

DRAFT LEGISLATIVE GUIDE ON PRIVATELY- FINANCED INFRASTRUCTURE PROJECTS

ANNOTATED TABLE OF CONTENTS

INTRODUCTION

A. Origin of the *Guide*
B. Arrangement of the *Guide*
C. Recommendations and illustrative provisions

Note

1. As was the case of the introductions contained in the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works* and in the *UNCITRAL Legal Guide on Countertrade Transactions*, it is suggested that the *Introduction* explain the origin of the *Guide*, its arrangement and style, the nature of its recommendations and provide other information of a similar nature.

I. SCOPE, PURPOSE AND TERMINOLOGY OF THE *GUIDE*

A. Transactions covered by the *Guide*
B. Purpose of the *Guide*
C. Terminology used in the *Guide*

Notes

2. It is suggested to provide, in the opening chapter of the *Guide*, information on the transactions it covers and on the purpose of the *Guide*, as well as an explanation of terms frequently used in the *Guide*.

3. An initial draft of chapter I is contained in document A/CN.9/438/Add.1.

II. PARTIES AND PHASES OF PRIVATELY-FINANCED INFRASTRUCTURE PROJECTS

A. General remarks
B. Private sector and public infrastructure
C. The concept of project finance
D. Parties to the project
    1. The host Government
    2. Project sponsors and project company
    3. Lenders and international financial institutions
    4. Other capital providers

5. Construction contractors and suppliers
6. Operation and maintenance company
7. Insurers

E. Phases of execution
1. Identification of the project
2. Selection of project sponsors
3. Preparations for the implementation of the project
4. Construction phase
5. Operational phase
6. Termination of the project

Notes

4. As an introduction to privately-financed infrastructure projects, it is proposed that chapter II contain general remarks on the concept of project finance, the parties to a privately-financed infrastructure project and the phases of its implementation. The purpose of chapter II is to provide the reader with background information and to facilitate making an informed choice of possible legislative solutions for the issues subsequently discussed in the *Guide*.

5. An initial draft of chapter II is contained in document A/CN.9/438/Add.2.

III. GENERAL LEGISLATIVE CONSIDERATIONS

A. Legal framework for privately-financed infrastructure projects
1. Legislative authorization
2. Legislative approaches to infrastructure projects

B. Other relevant areas of legislation
1. General business laws and property law
2. Settlement of disputes
3. Investment and taxation laws

C. National legislation and international agreements
1. International investment protection agreements
2. International trade instruments

Notes

A. Legal framework for privately-financed infrastructure projects

6. In the opening section of chapter III it is proposed to discuss two issues concerning the general legal framework for privately-financed infrastructure projects, namely, the legislative authorization for the host Government to undertake such projects and the legal regime to which they are subject.

7. The implementation of privately-financed infrastructure projects may require the enactment of legislation or the adoption of special regulations, particularly in those countries where the Government alone carries the responsibility for providing "public services", or for building or

expanding infrastructure. In countries with a well established tradition of awarding concessions to the private sector for the provision of "public services", or the development of "public works", there may be general rules providing that, in principle, any activity carried out by the State which has an economic value that makes it capable of being exploited by private undertakings may be entrusted to the private sector. Sometimes, such general legislation identifies those fields of activity or types of infrastructure that may be provided or developed by private entities. A different approach is to be found in countries that do not have such general legislation and that have preferred to enact specific laws covering privately-financed projects in particular fields of activity. In some countries, as a matter of legislative practice, it was considered appropriate to adopt specific legislation regulating the execution and operation of one or more individual projects. It is proposed to discuss the possible advantages and limitations of both general and project-specific or sector-specific legislation and the possibility of a combined approach of general and sector-specific legislation.

8. In adopting general or specific legislation, a number of States have found it desirable to issue some form of declaration of policy concerning private sector participation in public services and utilities, or an explanation concerning the objectives being pursued by the host Government. Declarations of policy may be useful means of reassuring potential sponsors, other equity investors and lenders of the governmental support to privately-financed infrastructure projects in the host country. Also, a public manifestation by the host Government of its commitment to pursue a policy favourable to privately-financed infrastructure projects may serve an educational purpose by informing the public about how it is expected that the governmental policy on privately-financed public infrastructure projects would generate benefits to the country.

9. Another issue proposed to be discussed concerns the legal regime of privately-financed infrastructure projects. In some countries, the relations between the project company and the host Government are regarded as being of a contractual nature, therefore placing both parties in a position of essential equality. In other countries, particularly in a number of civil law jurisdictions, privately-financed infrastructure projects fall under well-defined categories and rules of a body of law often referred to as "administrative law" (see chapter I, "Scope, purpose and terminology of the *Guide*"). The practical consequences of those different approaches to the legal regime of the agreement between the project company and the host Government may be considerable.

B. Other areas of legislation relevant to privately-financed infrastructure projects

10. In addition to issues pertaining to legislation immediately relevant for privately-financed infrastructure projects, it is proposed to consider in a separate section the possible impact of other areas of legislation to the successful implementation of those projects.

11. The business laws of the host country play a very important role in facilitating the implementation of the project. A privately-financed infrastructure project is often carried out by a company especially established by the project sponsors for that purpose. It is therefore important for the host Government to have an adequate company law with modern provisions on essential matters such as establishment procedures, management structure, issuance of shares, bonds and debentures and their sale or transfer, accounting and financial statements, protection of minority shareholders. Also, it is important that the national laws on commercial contracts and

securities provide adequate solutions to the needs of the project company and the lenders, including the possibility of assigning receivables generated by the project and flexibility in devising contracts as needed for the construction and operation of the infrastructure facility. Routine transactions of the project company may be further facilitated by adequate commercial banking legislation. Modern solutions for a number of relevant commercial law issues may be found in existing international legal instruments, including conventions and model laws that emanate from the work of UNCITRAL, such as the United Nations Convention on Contracts for the International Sale of Goods, the UNCITRAL Model Law on International Credit Transfers, the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit, the UNCITRAL Model Law on Electronic Commerce.

12. It is also desirable that the property laws of the host country reflect modern acceptable standards and contain adequate provisions on the ownership and use of land and buildings, as well as moveable property and intellectual property (copyrights, trademarks), ensuring the project company's ability to purchase, sell, transfer and licence the use of property, as appropriate. Particularly as regards the protection of intellectual property, a legal framework may be provided by adherence to international agreements regarding the protection and registration of international property rights.

13. Another important factor for the implementation of privately-financed infrastructure projects is the legal framework in the host country for the settlement of disputes. Project sponsors, contractors and lenders may be encouraged to participate in projects in countries that provide a hospitable and internationally acceptable legal climate for the settlement of disputes, as offered by the UNCITRAL Model Law on International Commercial Arbitration. The efficiency of the national judicial system, the expeditiousness of court proceedings and the availability of forms of judicial relief that are adequate to commercial disputes are additional factors to be taken into account, as well as the possibility of recognition and enforcement of foreign arbitral awards.

C. National legislation and international agreements

14. In the last section of chapter III it is proposed to consider the possible relevance for the laws of the host country governing privately-financed infrastructure projects of international agreements on the facilitation and promotion of global or regional trade in goods and services.

15. Those international agreements may contain provisions on the removal of barriers for the importation of goods or for the provision of services by foreigners in their contracting States. Provisions of that type may be relevant for national legislation on privately-financed infrastructure projects which contemplate restrictions on the participation of foreign companies in infrastructure projects, or establish preferences for national entities, or for the procurement of supplies in the local market.

16. One matter of particular concern for the project sponsors and the lenders is the degree of protection afforded to foreign investment in the host country. Such protection may derive from international agreements entered into by the host country for the encouragement and protection of foreign investment. The confidence of foreign investors in the host country may be fostered, for example, by protection from nationalization or dispossession without judicial review and adequate

compensation. Prospective project sponsors will also be concerned about their ability to transfer abroad or repatriate their profits. Another way of attracting foreign investment may consist in providing special tax regimes for private investors, such as exemption from corporate tax or other taxes, exemption from income tax for foreign personnel required to staff the project, exemption from real estate tax, tax concession on royalties, import duties.

IV. SELECTION OF THE PROJECT SPONSORS

A. General remarks
B. Possible methods for selecting the project sponsors
   1. Public tendering
   2. Request for proposals
   3. Direct negotiations
   4. Unsolicited proposals
C. Qualification criteria
   1. Requirements relating to the project sponsors
   2. Domestic preferences
D. Selection process
   1. Prequalification phase
   2. Invitation and proposals
   3. Evaluation and project award

Notes

A. General remarks

17. It is proposed that the opening section of chapter IV discuss general issues and possible approaches relevant for establishing an adequate legislative framework for the choice of methods and procedures for selecting the project sponsors. One important step is for the host Government to establish clearly the nature and scope of the works and services being procured. Also, the role envisaged for the private sector in any given case (for instance, whether the facility will be permanently or temporarily owned by the project company or whether it will be transferred to the host Government at the end of a certain period) might require special consideration by the host Government in devising qualification requirements and evaluation criteria. Furthermore, it is important to give appropriate weight to the long-term requirements of the operation of the facility which may be neglected if the law were to overemphasize the requirements of the construction phase for the purpose of selecting the project sponsors.

B. Possible methods for selecting the project sponsors

18. It is suggested that a section examine methods commonly used for the procurement of goods and services and consider their adequacy for infrastructure projects, particular attention being given to the UNCITRAL Model Law on Procurement of Goods, Construction and Services. Competitive methods are often referred to in national laws relating to privately-financed public infrastructure projects as primary or sole methods for selecting the project sponsors. Public tendering is the most common method for public procurement of goods and, in some cases, also services to be paid with public funds. However, given the complex nature of infrastructure

projects, alternative competitive methods, such as the "request for proposals" procedure, are sometimes preferred for the selection of the project sponsors.

19. In addition to competitive methods, other methods are sometimes referred to in national legislation, such as direct negotiations or, in the case of unsolicited proposals, single source procurement. Direct negotiations are sometimes allowed under exceptional circumstances, such as when for special reasons competitive methods would not lead to satisfactory results, or in the case of projects with an anticipated initial investment value not exceeding a certain amount or of a limited duration.

20. Another issue which is sometimes dealt with in national legislation on privately-financed infrastructure projects concerns unsolicited proposals. Some laws refer to general criteria for the admissibility and negotiation of unsolicited proposals, but do not provide further details on the treatment to be given to such proposals and the procedures to be followed. Admissibility criteria may generally include national priority, uniqueness and cost considerations. Another approach to unsolicited proposals may be to provide specific procedures for handling them, for instance by providing criteria for the review of unsolicited proposals, followed by submission of the project to competitive selection with some form of incentive or preference to the originator of the unsolicited proposal.

C. Qualification requirements

21. It is proposed to deal in a section with those conditions that have to be met by all prospective candidates regardless of the methods for selection of the project sponsors elected by the host Government.

22. The first group of requirements to be dealt with concerns requirements such as the financial standing of the prospective project sponsors, or their legal status. Some laws require a minimum rate of equity investment, as a percentage of the total investment cost, or establish a ceiling for the availability of public funds to the project. Such minimum investment may be complemented by provisions requiring the project sponsors to submit proof of adequate capability to sustain the financing requirements for the engineering, construction and operational phases of the project. There may also be negative criteria, such as rules declaring certain persons or categories of persons or companies to be ineligible for participating in the selection process (e.g. persons who, in one or the other form, participate in acts related to awarding the project, or companies that, having previously carried out a similar activity, had their concessions withdrawn by the State). It is proposed to consider the desirability for the law to deal with those requirements directly or to refer this matter to the procuring entity.

23. The second group of requirements proposed to be discussed in the same section can be found in provisions establishing some sort of preferential treatment for domestic entities or affording special treatment to candidates that undertake to use national goods or employ local labour. Such preferential or special treatment may be provided as a condition for the selection of the project sponsors, as a criterion for the evaluation of offers, or as an obligation imposed on the project company. In some laws such preferential treatment takes the form of special evaluation criteria establishing margins of preference for national candidates, or candidates who offer to

procure supplies, services and products in the local market. Yet other laws do not expressly refer to the use of domestic supply sources as an evaluation criterion, but include it among other elements to be mandatorily or voluntarily included in the offers. Other laws provide that, all other things being equal, preference should be given to national candidates. It is important, where such preferences are established, to weigh the advantages expected from such domestic preferences against the particular needs of the project. It is also important to ensure transparency in the application of such domestic preferences as criteria for awarding the project.

D. Selection process

24. It is suggested that a section describe and analyse the legislative framework of a typical competitive selection process for infrastructure projects in two subsections, one dealing with provisions concerning prequalification criteria and one dealing with provisions governing the ensuing proceedings, including solicitation of tenders or request for proposals, content of tenders or proposals, feasibility and other studies, tender securities, evaluation of tenders or proposals, award of the project and dispute resolution.

25. The first issue proposed to be considered in the subsection dealing with prequalification of sponsors relates to the invitation to prequalify, its mode of circulation and content. As to the prequalification requirements, it is proposed to discuss matters such as requirements concerning the legal status of the project sponsors, as well as experience and past performance (which may cover aspects such as past performance of the sponsors with similar or related projects, experience of their key personnel, organizational and financial capability).

26. Provisions governing the steps that follow the prequalification of tenderers or proposers are suggested to be considered in the following subsection. It is desirable that instructions to prospective project sponsors indicate in detail the aspects to be covered by their tenders or proposals, including technical, financial and legal proposals. Particular importance is to be given to the studies, such as feasibility studies to be submitted with the tenders or proposals, which should normally address issues such as marketability, engineering design, economic, financial and operational feasibility of the project, as well as an environmental impact study. The importance for the host Government to conduct or obtain its own feasibility studies would also be discussed. Another aspect to be covered in the instructions issued by the host Government concerns the criteria to be applied for the evaluation of tenders or proposals. In general, it might not be desirable to burden the legislation with details of the selection process. However, to a certain degree national legislation may play an important role in providing guidance to the procuring entity with regard to all those aspects. Likewise, national legislation may establish an appropriate framework for the function of the procuring entity during the remaining phases of the selection process. The law may, for instance, authorize that the final submission of tenders or proposals be preceded by a conference in which the parties have an opportunity to clarify questions concerning the project, and as a result of which the host Government may amend or rectify the instructions, as appropriate. It is proposed to conclude this subsection with a discussion of final negotiations and award procedures, as well as of appropriate mechanisms for solving disputes relating to the award of the project.

V. PREPARATORY MEASURES

A. The site of the project
   1. Acquisition of land for the construction of the facility
   2. Rights of way and other easements
B. Establishment of the concessionaire
   1. The concessionaire as a consortium
   2. The concessionaire as an independent legal entity
C. Licences and approvals

Notes

27. It is proposed to discuss in chapter V a few important steps in the preparations for the implementation of the project: the acquisition of land for the construction of the facility, including access to the project site; the establishment of the consortium or company that will receive the concession to build and operate the infrastructure facility; the issuance of licences and approvals necessary for carrying out the project activities. It is suggested that chapter V consider the extent to which national legislation could adequately address those issues without depriving the parties of the flexibility necessary for meeting the needs of individual projects.

28. An initial draft of chapter V is contained in document A/CN.9/438/Add.3.

VI. THE PROJECT AGREEMENT

A. General considerations
B. The rights of the project company
   1. Property rights
   2. Exclusivity
C. General obligations of the project company
   1. Project execution and related obligations
   2. Guarantees of performance
   3. Liability and insurance
D. Subconcession, assignment and securities
   1. Subconcessions and assignment of the project
   2. Securities and encumbrances

Notes

A. General considerations

29. It is proposed to deal in one section with general considerations concerning the project agreement, discussing in particular the different approaches taken by national legislation concerning the project agreement (from those that scarcely refer to the project agreement to those that contain extensive mandatory provisions concerning clauses to be included in the agreement). Such a section would consider the possible advantages and limitations of existing approaches, taking into account the possibly varying need for legislative guidance on preparing a project agreement that may exist at different levels of Government (national, provincial or local). The remaining sections would deal with rights and obligations of the project company that, in addition

to being dealt with in the project agreement, might be usefully addressed in the legislation, as they might affect the interests of third parties.

B. The rights of the project company

30. It is proposed to deal with the nature of the rights and interests of the project company in the facility and related property, a question for which various solutions can be found. In some countries the law expressly provides that title to all assets originally furnished by the host Government for the construction of the facility, as well as all facilities and improvements built by the project company, is vested in the host Government throughout the duration of the agreement. Other laws, however, give the project company some type of property right and provide in detail its nature and scope. It might be desirable for the relevant legislation to clarify the nature of the property rights of the project company, an aspect that is of particular importance where the legislation allows the establishment of some sort of security interest in those assets and property. Also, where the legislation requires the transfer of the facilities to the host Government at the end of the concession period, questions might arise as to who holds title to improvements made to property originally received by the project company.

31. It is further proposed to deal in the same section with two other questions particularly important for project sponsors and lenders (but also relevant for the host Government and the users of the facility), namely whether the concession is exclusive and whether competing facilities will be allowed to operate. Project sponsors and lenders will be interested in obtaining assurances that the facility will generate sufficient revenue to repay the project company's debt, recoup the investment and allow them a reasonable profit. Thus, national laws often authorize the host Government to grant an exclusive right to the project company to pursue the activity that is the object of the concession. In some cases, the host Government undertakes not to provide public funding for parallel projects that might generate competition to the project company. However, such exclusivity is not always guaranteed by the law. In some cases, the host Government may reserve the right to grant multiple concessions in the same area, provided this is specified in the solicitation of tenders. In some cases, the host Government is authorized to grant concessions under a regime of "regulated exclusivity" where the operation of the facility by the project company is monitored by a regulatory body so as to ensure that it meets the interests of the public, an aspect to be considered in more detail in chapter IX, "Operational phase".

C. General obligations of the project company

32. The obligations of the project company concerning the construction and operation of the facility are provided in some national laws by a general reference to the project company's obligation to finance, build, operate and maintain the facility, while other national laws include more extensive lists of obligations such as to supply adequate service or to observe and ensure observance of rules and regulations relating thereto. Particularly with a view to the eventual transfer of the facility to the host Government, some laws require that the project agreement contain provisions on technology transfer and stipulate the manner in which local personnel designated by the host Government will be given adequate technical training.

33. The obligations of the project company are sometimes complemented by the provision of some form of guarantee of performance or insurance against the consequences of default. The

law may generally require that adequate guarantees of performance be provided by the project company and refer the matter to the project agreement for further details. Some laws, however, contain more detailed provisions, for instance requiring performance bonds up to a certain percentage of the basic investment to be presented by the project company at the time of project commencement. Different guarantees of performance may have to be provided for the construction and for the operational phases. The host Government may also wish to require a guarantee for the performance by other companies associated in the execution of the project or sufficient evidence that the project sponsors have raised funds or secured finance sufficient for the carrying out of the project. One aspect to be considered is that, depending on the terms of the performance bond, serious guarantors may not be able to issue a bond for the whole duration of the project. It is proposed that the *Guide* consider the possible implications of prescribing specific types of guarantees in the legislation, rather than leaving this matter to be addressed in the project agreement.

34. Another issue proposed to be dealt with in the same section relates to legislative provisions dealing with damage caused to third parties in the course of the execution of the project or the operation of the facility. The project company is normally liable for damages caused to the host Government, the users of the service or third parties which result from the project company's negligence. In some cases, such liability extends to liability for environmental damage. For the purpose of ensuring that the project company will meet its liability, some laws require that the project company purchase and maintain adequate insurance, including workmen's compensation insurance, while other laws establish an option of self-insurance against specific forms of liability, subject to approval by the host Government, in the event no insurance is available at a reasonable cost in the national or international insurance markets.

D. Subconcession, assignment and securities

35. It is proposed that a section discuss the questions of subconcession, assignment of the project company's rights and security interests established to the benefit of the project company's creditors.

36. In cases where the project company is given the right to provide ancillary services, or where the concession involves multiple activities capable of being carried out separately, the project company may wish to engage another entity to carry out some of those activities. Some laws require that the project agreement prohibit a subconcession or any arrangement to that effect, in whole or in part, without prior approval of the host Government. A different approach can be found in national laws which, while still requiring prior approval by the host Government, authorize subconcessions provided that the subconcession is awarded through a competitive method and the subconcessionaire assumes all the rights and obligations of the concessionaire within the scope of the subconcession.

37. During the life of the project, it may happen that third parties become interested in substituting for the project company. Also, situations may arise where, due to the failure or inability of the project company to perform its obligations, it might be in the interest of the parties to allow the project to continue under the responsibility of another company or consortium. This may be done by means of an assignment of the concession to a third party.

Few laws prohibit categorically any assignment of the concession, while other laws authorize such an assignment, subject to approval by the host Government, which may also be required for a transfer of the right to control the project company. The lenders, whose main or sole recourse is the revenue generated by the project, may have an interest in ensuring that the works will not be left incomplete and that the concession will be operated profitably in the case of inability of the project company to do so. In some cases, the law recognizes such an interest and provides that under certain circumstances the lenders may have an option to appoint a new project company to substitute for the initial project company, subject to approval by the host Government.

38. One essential factor for obtaining financing for the project is the ability of the project company to offer acceptable security interests to the lenders, such as mortgages or assignment of receivables generated by the project. Some laws expressly recognize that interest by allowing the project company to create a security interest over the concession, the rights arising from the concession or the property involved, with the consent of the host Government. Some laws specifically authorize the establishment of mortgages or other security interests in the project's property, provided that such property continues to be used for the purposes of the concession. Some laws, however, strictly prohibit the establishment of any encumbrance on the concession or the rights related to it, or provide that the concession agreement may contain such a prohibition. It is proposed to discuss the possible implications of those approaches.

VII. GOVERNMENT SUPPORT

A. Financial support
   1. Sovereign guarantees
   2. Loans and revenue assurances

B. Incentives, facilities and benefits
   1. Taxation and customs
   2. Ancillary revenue sources
   3. Other assurances and facilities

Notes

A. Financial support

39. The proposed topic for the opening section of chapter VII relates to financial measures that may be taken by the host Government for the purpose of reducing the commercial, financial, political or other risks faced by the project company and the lenders. One of the host Government's motivations for pursuing privately-financed infrastructure projects is often to limit the commitment of public funds, a motivation which is reflected in those laws that provide that the concessionaire alone is responsible for the financial viability of the project with no guarantees being given by the host Government. Other laws, in turn, with a view to encouraging private investment, authorize the host Government to share the project risks by contemplating some form of financial support by the host Government, in the form of guarantees or loans, without which the project might not materialize. It is proposed to consider the desirability of allowing some flexibility for the host Government in devising the level of support it may provide to the implementation of the project. For that purpose, it is suggested to examine types of support that are sometimes contemplated in national legislation, and which in some countries might require special legislative authorization.

40. Guarantees contemplated in national laws may include: foreign exchange guarantees such as the guarantee that the revenue generated by the facility may be converted into foreign currencies, for the purposes of repaying loan capital and interest, paying expenditures requiring foreign currency, or paying to foreign investors their share of profits; guarantees of payment of goods and services supplied by the project company when the goods or services are supplied to the host Government or a public entity; loan guarantees concerning the repayment of loans taken by the project company. Since the project company's ability to repay loans is essentially predicated upon the revenue generated by the project, a governmental guarantee of repayment of loans might assure the lenders and the project company that they would not be unreasonably exposed in the case of early termination of the agreement or other unforeseeable changes of circumstances or emergency situations outside the control of the project company that render the project company temporarily unable to operate the project or meet its financial obligations. Some forms of guarantees provided by the host Government may be supported by a guarantee issued by international financial institutions, such as the World Bank. Some of those institutions may give guarantees or provide insurance coverage against a number of risks directly to the benefit of the private sector.

41. In addition to guarantees, in some cases the host Government, directly or through a governmental agency, may itself extend certain loans to the project company for specific purposes, such as to cover possible loss or damage caused by the host Government or due to *force majeure* events, or to finance modifications of the project agreement. Such loans may require the provision of some collateral by the project company, such as a mortgage of real estate provided to the project company for the development of the project. The provision of such loans, like loan guarantees, might be a way for the host Government to share the project risks without an up-front commitment of public funds. From the perspective of lenders and sponsors, such risk-sharing might be significant for reducing or limiting their exposure to loss that results from unilateral acts of the host Government or other events beyond the control of the project company.

42. Another type of financial support may be an assurance by the host Government of a minimum revenue to the project company. When the Government or a governmental entity is the sole customer for the services or goods supplied by the concessionaire, the law sometimes provides that the Government or some governmental entity will be under an obligation to purchase such goods and services, at an agreed rate, as they are offered by the concessionaire. With regard to services provided directly to the public, the host Government sometimes undertakes to subsidize the project company, in the event that officially approved tariffs fall below the level provided in the project agreement. In other cases, the project company is paid a flat or variable sum directly by the host Government, on the basis of an estimated number of paying users of the facility arrived at in the course of the selection process.

B. Incentives, facilities and benefits

43. It is proposed to deal in a separate section with other forms of support that are often provided to privately-financed infrastructure projects. The host Government may grant some form of tax and customs exemption, reduction or benefit to the project company (e.g. to facilitate the import of equipment for the use of the project company by means of exemption of customs duties), or may establish some preferential tax treatment. Sometimes the law authorizes the host Government either to grant an exemption from customs duty or to guarantee that their level will not be raised to the detriment of the project.

44. One form of reducing the commercial risk to which the project company is exposed may consist in offering the possibility of additional concessions for the provision of ancillary services or the exploitation of other activities. By giving the project company alternative sources of revenue the host Government could make it possible for the project company to follow a policy of low or controlled prices for the main service. Thus, some laws authorize the host Government to provide in the solicitation of tenders that the concessionaire will be given the possibility of other revenue sources from alternative, complementary or ancillary projects, with or without exclusivity, with a view to encouraging low tariffs. The law sometimes provides that the host Government may grant the project company the right to use property belonging to the host Government for the purposes of such activities (e.g. land adjacent to a highway for construction of service areas).

45. Additional assurances and facilities that may be provided by the host Government to the project company may include the provision of various forms of insurance coverage to the project

company or its employees, or an assurance that the project company will be provided with, or will have facilitated access to, supplies, goods and facilities which are needed for the operation of the infrastructure facility.

VIII. CONSTRUCTION PHASE

A. Contractors of the project company
   1. Award procedures
   2. Contractual regime

B. Project development
   1. Monitoring of project development
   2. Acceptance and final approval

Notes

A. Contractors of the project company

46. Given the complexity of infrastructure projects, the project company is likely to retain one or more contractors for performing the works under the project agreement. It is proposed that a section of chapter VIII deal with the procedures for selecting those contractors and with the laws governing their contracts with the project company.

47. Two basic approaches have been used for dealing with the selection of the contractors of the project company. Some laws require the project company to identify in its tender or proposal the contractors that will be retained, including information on their technical capability and financial standing; other laws only require prospective project sponsors to indicate the percentage, if any, of the total value of the work which they intend to assign to third parties. There are also laws that require the project company to observe essentially the same procedures for selecting its contractors as were applied to the selection of the project company itself, an obligation which may also extend to the subcontractors of the contractors.

48. The group of project sponsors often includes engineering and construction companies, which participate in the selection process in the expectation that they will be given the main contracts for the execution of the construction and other works. Those companies might be reluctant to join the other project sponsors if they had no assurance of being awarded those contracts. One possible solution might be to have a rule similar to the procurement rules of some international financial institutions, which provide that, where the project company was selected under a competitive method acceptable to such financial institutions, the project company is free to use its own procedures to procure goods, works and services required for the facility. However, where the project company itself was not selected through a competitive method acceptable to such financial institutions, the goods, works and services required for the facility have to be procured through a competitive method.

49. It is common for the project company and its contractors to choose a law that is familiar to them and that in their view adequately governs the issues addressed in their contracts. Prospective project sponsors would not normally be inclined to subject their contracts to a legal

system that is unknown to them and might, therefore, be reluctant to participate in a project if the laws of the host country subject all their contracts to its national law, or require the approval of the host Government for the application of foreign law. In most cases, however, Governments have found no compelling reason for making provisions on the law applicable to the contracts between the project company and its contractors, and have preferred to leave this question to a choice of law clause or to the rules on conflict of laws. In some cases, provisions have been included for the purpose of clarifying, as appropriate, that the contracts entered into between the project company and its contractors are exclusively governed by private law, that the contractors are not agents of the host Government, and that, accordingly, the host Government has no liability for the acts of the contractors or no obligation to pay compensation for work-related illness, injury or death to those contractors' employees.

B. Project development

50. In section B of chapter VIII it is proposed to discuss legal issues relating to the development of the project, including procedures for monitoring the progress of the construction works and for the final acceptance of the infrastructure facility.

51. National laws often contain provisions concerning the development of the project and the procedures to ensure compliance by the project company with the engineering design and technical specifications. The initial construction project may be subject to review by the host Government so as to ensure that it conforms to the specifications and technical requirements for the development of the project. For the purpose of avoiding delay in the commencement of the construction, the law may establish deadlines for the approval of the construction project by the host Government and provide that the approval is deemed to be granted if no objections are made by the host Government within a certain period. Should the host Government find that the construction project deviates from the specifications, the law sometimes expressly provides that the host Government will have the right to request modifications in the project, and clarifies that the host Government will not be liable for delays that result from the need to make such modifications. In some cases, in addition to setting a deadline for the review of the construction project by the host Government, the law may expressly limit the grounds on which the host Government may raise objections to the project and establish rules for solving disagreements.

52. Following approval of the construction project, the law often provides for continued monitoring by the host Government throughout the construction phase. The law may deal with the execution of the project in several stages, in accordance with the time-table provided in the project agreement, and require governmental approval for the formal completion of each stage. For the purpose of facilitating the liaison between the host Government and the project company, the law sometimes requires the host Government to designate one officer to exercise all monitoring functions provided in the law, or indicate which governmental organ is to do so. In some projects it was found useful to require the project company to appoint an independent project manager, through whom all communications with the relevant governmental entity would be channelled.

53. When the works performed by the project company are found to be unsatisfactory or inconsistent with the specifications, the law sometimes provides that the project company may be

subject to penalties or liquidated damages as provided in the project agreement. It is proposed to discuss this matter in chapter X, "Performance issues".

54. Upon completion of construction, some laws provide for a final inspection and approval of the works by the host Government, as a condition for authorizing the project company to operate the facility. The law may also authorize a provisional operation of the facility, pending final acceptance by the host Government. The final inspection of the facility sometimes includes the testing, as required, of any equipment installed by the project company, so as to ensure that it is in proper operating condition, providing an opportunity for the project company to cure defects that might be found at that juncture. In respect of facilities to be used by the public, provisions of this kind may be of great importance for the host Government, particularly in those countries where the State would have a direct or residual liability to the public for damage or injury attributable to defects in the construction of the facility. In the case of other facilities closed to the public and normally accessible only by the project company and its personnel, the public interest may be less prominent, and the host Government may satisfy itself with requiring the project company to undertake those tests, subject to the general monitoring rights of the host Government.

IX. OPERATIONAL PHASE

A. General regulatory considerations
B. Conditions of operation
   1. Scope and quality of services
   2. Price and price increases
   3. Relations with users
C. Inspections and monitoring
   1. General inspection measures
   2. Special monitoring powers

Notes

A. General regulatory considerations

55. It is proposed to deal in the opening section of chapter IX with general regulatory issues concerning the operation of the infrastructure facility by the project company. In pursuing private-sector participation in infrastructure, Governments usually expect to achieve efficiency gains and high standards of service, which sometimes may not be provided by self-regulated State monopolies. Where multiple concessions are awarded for the same sector, the host Government may expect that the competition among the concessionaires will have a certain regulatory effect and will be conducive to achieving efficiency and quality targets. However, Governments may find that the market cannot always be relied upon for solving issues relating to the operation of the infrastructure facility in a manner that satisfies the public interests, so that some form of external regulation might still be necessary. Even greater might be the need for such external regulation in the case of exclusive concessions where a natural monopoly takes the place of a State monopoly.

56. In some cases, the host Government may attempt to address all regulatory issues (e.g. quality of services, level of tariffs) in the project agreement or in the pertinent legislation, an approach which may not always be adequate to the long-term nature of privately-financed infrastructure projects. In other cases, the project company might be given great freedom to establish its own commercial and pricing policies, a solution which some Governments might be reluctant to adopt. Governments that wish to reserve for themselves the possibility of regulating the operation of the infrastructure facility sometimes give such power to the same authority that awarded the concession. Other Governments, however, may prefer to establish another body for that particular purpose and give such body certain latitude in the exercise of its functions. However the mechanism is conceived, Governments might find it useful to provide a certain level of legislative guidance for the exercise of such regulatory functions.

B. Conditions of operation

57. After the above general regulatory considerations, it is proposed to deal in a separate section with three basic issues relating to the conditions of operation of the infrastructure facility: the scope and quality of the services provided by the project company, the establishment and adjustment of the price charged by the project company, and the relations of the project company with the purchasers of the goods or services or the users of the facility.

58. The law may sometimes mention in general terms the scope of the services to be provided by the project company, particularly those laws governing one particular sector or service. Sometimes the scope of the services and the manner in which they have to be provided may be subject to rules issued by the competent regulatory body, or rules issued by the project company, with that body's approval. In addition to general rules concerning the scope of the services, some laws provide criteria for assessing the quality of the services to be provided by the project company as well as general definitions of applicable standards of quality. Another approach is to leave this matter to the project agreement.

59. Although recognizing that the terms of the concession are subject to the agreement of the parties, in some legal systems the host Government has the right to change the scope and characteristics of the services to be provided by the project company for reasons of public interest, subject to compensation for financial loss or additional costs that result for the project company from such unilateral changes by the host Government.

60. As regards the prices charged by the project company, two basic approaches have been observed: in some cases the project company is free to determine its pricing and commercial policy, while in other cases the law subjects the initial price charged by the project company to some control mechanism (e.g. approval by the competent regulatory body, or requirement that the prices be provided in the project agreement). The competent regulatory body may have to approve criteria and parameters to be followed for determining reasonable price levels that allow the project company to recover the investment and achieve a reasonable rate of return. In some cases, the law itself may provide the method for determining the prices to be charged by the project company.

61. In addition to making provision for determining the initial prices, national laws may provide rules governing the adjustment of those prices during the term of the agreement. The

proposed tariff level is often an important, if not decisive factor in the selection of the project sponsors. Thus, the host Government may have an interest in establishing reasonable limits for increase of tariffs so as to discourage prospective project sponsors from submitting unrealistically low proposals in the expectation of being able to raise the tariffs at a later stage. Criteria and parameters for price adjustments are sometimes indicated in the law, as in the case of official price indices. In addition to variations in official price indices, some laws provide that the competent regulatory body will authorize price adjustments when the costs of the project company rise as a result of an act of the host Government including changes in taxation subsequent to the project agreement. For the purpose of devising appropriate mechanisms for price adjustments, it is desirable that the host Government bear in mind the expectations of other parties involved. For instance, the lenders might need a pre-determined formula for price adjustments in order to estimate the revenue of the project. Thus, the lenders might wish to have such formula reflected in the project agreement, or some other document of general application, rather than being subject to the sole discretion of a regulatory body. Therefore, when a regulatory body is given the authority to approve parameters or conditions for price increase, the lenders might find some comfort in that the guidelines for the exercise of such authority are provided by the law. Another related issue is the extent to which, in the interest of the project, the law may exempt the project company from specific legislation relating to price and tariff control or providing special treatment in favour of certain categories of users.

62. Where the project company provides a service directly to the public, the law sometimes contains provisions regulating their relations or spelling out the rights and obligations of the users of the service concerned. The project company is often required to provide the service without discriminating against any group of users, except for differences based on objective considerations, such as the technical characteristics and the specific costs resulting from providing the service for different categories of users. In some cases, the project company may be required to enter into contracts with the users of the service or the consumers of the goods supplied by the project company (such as gas, water or electricity). Depending on the nature of those goods or services, the law may establish a chain of legal arrangements, each governed by a different contract, such as between energy producer and transporter, energy transporter and energy distributor and energy distributor and consumer.

63. In some cases, the project company is required to establish procedures for dealing with complaints and claims by the users of the service. In other cases, the law entrusts the competent regulatory body or other governmental agency with the responsibility of protecting the interests of the users of the service and guaranteeing their right to file complaints with such agency.

C. Inspections and monitoring

64. Given the importance of infrastructure projects for the host Government, and the Government's ultimate accountability for the quality of services provided to the public, the host Government is likely to retain the right to monitor the operation of the facility. Possible legislative approaches vary from laws which appoint officers to carry out inspections, specify the powers given to them and describe in detail the procedures for such inspection, to those laws that only refer to such inspection and monitoring powers in general terms and require that the relevant procedures be provided in the project agreement. Furthermore, the project company may be

required to report regularly to the competent regulatory body on the operation of the facility or to submit special reports upon request. The consequences for the project company of a breach of its contractual or statutory obligations may include fines or other pecuniary sanctions, as provided in the law, an issue which is proposed to be considered in chapter X, "Performance issues". In general, however, the exercise by the host Government of such monitoring functions does not relieve the project company of its own liability for damage sustained by the host Government, users or third parties as a result of the breach of its obligations.

65. It is generally desirable that inspections and control measures be carried out in such a manner so as to cause the least possible disturbance to the operation of the facility or to avoid unreasonable intervention in its operation. With regard to the cost of inspection and related measures, some laws provide that the project company may be required to bear such costs, as determined by the host Government, whereas other laws refer this matter to the project agreement.

66. In addition to general inspection powers, some national laws authorize the host Government to assume control over, and temporarily administer, the facility for reasons of public interest. In some countries, the powers of the officer responsible for the temporary administration are set out in the law and generally do not include disposing of assets, or requesting the termination of the concession. With a view to reassuring prospective project sponsors and lenders that such powers will not be arbitrarily or unreasonably exercised, the law may spell out those exceptional circumstances which may authorize the host Government to appoint a temporary administrator (see also above, para. 37).

X. PERFORMANCE ISSUES

A. Delays, defects and other failures to perform
   1. Definition of failure to perform
   2. Failure during the construction phase and during the operational phase
B. Exemption provisions
   1. Definition of exempting events
   2. Consequences for the parties
C. Change of circumstances
   1. Acts of the Government
   2. Hardship provisions

Notes

A. Delays, defects and other failures to perform

67. It is proposed to deal in a section with performance failures by the project company, an issue to which different approaches have been used in national laws. In some countries the legislation does not contain specific provisions on this matter, which is left for the project agreement. Other laws, however, contain generally worded provisions defining breach of contract by the project company and providing remedies, which constitute a general framework for more detailed provisions in the project agreement or in specific regulations. In making provisions on this issue, it might be desirable to distinguish, as some laws do, between failures that occur during the construction phase and failures in the operation of the facility by the project company.

68. The project company may be required to take a number of measures before the execution of the project (e.g. to secure the necessary financial means; to prepare the technical documentation; to sign the project agreement within a certain period from the award of the concession; to establish the project company; to obtain licences or permits). Remedies available to the host Government in the event of failure by the project company to meet those conditions may take different forms, including, for particularly important conditions, the termination of the project agreement. In those cases, it might be desirable to provide that the host Government will give written notice to the project company to meet pending conditions, prior to terminating the project agreement. With regard, in particular, to termination for failure to obtain licences, it might be further desirable to specify that no termination would take place when the failure is not attributable to the project company's fault. Such a provision might reassure lenders and sponsors that they would not be penalized, for instance, by inaction or error on the part of the host Government or its agents.

69. During the construction phase, performance failures might relate to two broad categories: delay in construction and defective construction. Remedies available for failures at that stage may include payment under guarantees provided by the project company, payment of liquidated damages or penalties, or fines. Generally, it might be sufficient for the law to require that the project agreement contain provisions on this matter, rather than to establish a scheme of remedies

applicable to all types of projects. In most situations, it might be advisable to treat the termination of the project agreement and withdrawal of the concession as last resort measures to be used only in case of particularly serious or repeated failures, or when it can no longer be reasonably expected that the project company will be able or willing to complete the work or cure the defects. In some countries, special procedures apply for establishing the failure of the project company prior to resorting to contractual remedies. Both the host Government and the lenders will be interested in ensuring that the construction of the facility is completed. Thus, in some cases, rather than terminating the agreement and assuming the responsibility for, and the cost of, the completion of the facility, the host Government might wish to give the lenders the opportunity to appoint a substitute company, acceptable to the host Government, to complete the unfinished infrastructure facility and bring it into operation (see above, para. 37).

70. Also, during the operation of the facility, it might be desirable for the law to give the parties the possibility of establishing a hierarchy of remedies available to the host Government, according to the seriousness and repercussions of the failure by the project company, which might be accompanied by provisions prescribing the procedures for establishing performance failure and resorting to available remedies. In some legal systems, the host Government has the right to take over temporarily the operation of the facility, normally in the case of serious failure to perform by the project company. Some laws may provide that certain events justify the withdrawal of the concession. Here, too, it might be desirable to limit the withdrawal of the concession during its operation to particularly serious circumstances.

B. Exemption provisions

71. In drafting national legislation, it is desirable to take into account events that might preclude the project company, temporarily or permanently, from performing its contractual obligations and that are often referred to by expressions such as "*force majeure*" and other terms with similar meaning. Such impediments may be the consequence of natural phenomena, such as fire, storms or flood, or of human actions, such as war, riots or revolts. The occurrence of an exempting event may sometimes justify the suspension of the project execution or the operation of the concession for the duration of the impediment subject to a maximum period of suspension. Whether or not the project company will be entitled to claim compensation from the host Government or whether the host Government will share some of the costs entailed by the suspension of the project are questions to which national laws provide different answers. A procedure for determining, in a given case, whether an event falls within the category of *force majeure* is sometimes spelled out in the law.

C. Change of circumstances

72. Some laws deal with the rights of the project company in the event the execution of the project is prevented by an act of the host Government. In some cases, the relevant rules contain a general undertaking by the host Government not to interfere with the execution of the project, except under special circumstances. In other legal systems, however, the host Government usually has the right to alter the terms of a concession when the public interest so requires, subject to compensation to the concessionaire. If the execution of the project is interrupted as a consequence of a governmental act, the project company may be entitled to an extension of the concession period as well as compensation for the damage it sustained. While in some cases it

might be impliedly understood that the host Government will be responsible to pay such compensation, it might be advisable to include a specific provision in the legislation to that effect, so as to reassure the project company that it would not have to bear additional costs as a result of governmental acts which were not prompted by any failure on its part.

73. Another related matter concerns changes in factors that, without preventing the performance of contractual obligations, render the performance by the project company considerably more onerous than foreseen at the time those obligations were assumed. Some legal systems have special rules dealing with such situations, which allow a revision of the terms of the project agreement so as to restore its original economic equilibrium. In some cases, the possibility of a revision of the terms of the agreement is generally implied in all governmental contracts, or is expressly provided for in legislation. Some laws on privately-financed infrastructure projects generally recognize the possibility of such changes of circumstances but refer the matter to the project agreement for concrete solutions.

XI. EXPIRY, EXTENSION AND EARLY TERMINATION OF THE PROJECT AGREEMENT

A. Expiry of the project agreement
   1. Term of the project agreement
   2. Transfer of the facility and related measures
B. Extension of the project agreement
C. Early termination of the project agreement
   1. Grounds for early termination
   2. Consequences for the parties

Notes

A. Expiry of the project agreement

74. It is suggested to discuss the expiry, extension and early termination of the project agreement, dealing first with the consequences of the expiry of the term of the project agreement and the transfer of the project to the host Government at the end of the project period.

75. Many national laws limit the duration of the concession to a maximum number of years, which sometimes expressly include the construction period, as well as any extension given for reasons of *force majeure*. The rationale for including the construction period in the total concession period is to encourage the project company to complete the construction works ahead of schedule, so as to benefit from a longer period of concession. In some cases, however, Governments have preferred to establish a combined system whereby the project agreement ends once the debts of the project company have been fully repaid and a certain revenue, production or usage level has been achieved, subject to a maximum limit of a fixed number of years.

76. In a typical "build-operate-transfer" project, the infrastructure facility is normally transferred to the host Government at the end of the concession period. Some laws expressly provide that the assets to be transferred include not only those originally provided to the project

company, but also those assets, goods and property subsequently acquired by it for the purpose of operating the facility, while other laws leave this question to be clarified in the solicitation of tenders or in the project agreement. Some laws specifically provide that, upon termination of the concession, the host Government will compensate the project company for the cost of those improvements made upon the original property for the purposes of ensuring the continuity of the service which at that time have not yet been recovered by the project company. The host Government in those cases has the right to receive the assets and property related to the concession in good and operating condition. For that purpose, the project company may be required to provide some sort of financial guarantee. In some cases a special inspection of the facility takes place prior to the termination of the concession, as a result of which the host Government may require additional maintenance measures by the project company so as to ensure that the facility is in proper condition at the time of the transfer. In some cases, the law provides that guarantees given by the project company will have to be extended until the facility is received by the host Government to its satisfaction, and that the host Government may draw on such guarantees to pay the repair cost of damaged assets or property.

B. Extension of the project agreement

77. In the second section of chapter XI it is proposed to consider the possibility of an extension of the project agreement, an issue on which different solutions are found in national laws. Some laws authorize one or more extensions of the concession period for an equal or shorter term, while other laws generally prohibit extensions, save for exceptional conditions, such as to allow the project company to recover the cost of extraordinary work required to be done on the facility.

78. Limitations on the extension of the concession period are sometimes provided as a protection for the host Government against demands by the project company. In some cases, with a view to encouraging competition in the sector concerned, the law requires the host Government to submit the concession, upon its expiration, to public tendering, in which case the project company may be given a margin of preference over other equally qualified candidates.

C. Early termination

79. It is suggested to discuss in a separate section the events or circumstances that cause or justify the early termination of the project agreement and the consequences that derive therefrom for the parties.

80. Main grounds for early termination normally include any of the following: the opening of certain types of insolvency proceedings in respect of the project company; the expropriation of the project company; the termination for reasons of public interest; the inability or serious failure by the project company to perform its obligations; or the failure by the host Government to perform its obligations.

81. The expropriation of the concession, or its take-over by the host Government for reasons of public interest, is typically subject to a special procedure and payment of appropriate compensation. A few laws expressly give the project company the right to terminate the agreement in the event of default or failure by the host Government to perform its obligations.

82. In the event of insolvency, failure or inability of the project company to continue to provide the service, it may be in the interest of the host Government to make provisions to avoid the interruption of the service. The law may provide that, in such cases, the host Government may appoint a temporary administrator so as to ensure the continued provision of the relevant service, or give the lenders the right to substitute for the project company, or appoint a substitute. Some laws provide for the continuation of such temporary administration until the creditors admitted to the insolvency proceedings decide, upon recommendation by the insolvency administrator, whether the activity will be pursued or whether the right to exploit the concession will be put to auction. In some cases, the law excludes the assets and property related to the concession from liquidation or insolvency proceedings, or requires prior governmental approval for any act of disposition by a liquidator or insolvency administrator (see also above, para. 66).

83. Unlike early termination as a sanction for the project company's failure to perform its obligations, an early termination for reasons of public interest is not normally attributable to acts of the project company, a distinction which may be taken into account by the law when determining the compensation to be paid to the project company in each case.

XII. GOVERNING LAW

Notes

84. It is proposed to deal in a chapter with the issue of the law applicable to privately-financed infrastructure projects and the possible implications of different laws applying to different aspects of the project.

85. Some national laws on privately-financed infrastructure projects contain provisions on the law that applies to the project agreement between the host Government and the project company, often mandating the application of national law. Depending on whether the legal regime of the concession is regarded as a contract or as an act of Government (a question to be addressed in chapter III, "General legislative considerations" and chapter VI, "The project agreement"), the law might give preference to either private or administrative law. In the latter case, a different approach is taken by those laws that provide for the subsidiary application of administrative law only, or that establish a hierarchy of legal provisions applying to the project. In general, it might be desirable to clarify in the law whether and to what extent the project agreement may deviate from, or supplement, the provisions of such legislation.

86. In some countries, the law governing privately-financed infrastructure projects does not contain a specific provision on the extent to which the project agreement may be subject to a law other than the law of the host Government. Another approach used has been to list the areas in which the law of the host country is to apply (e.g. transfer of technology, accounting, labour relations, foreign exchange control) and to provide that in respect of issues not governed by the laws of the host country, the project agreement may be made subject to a foreign law.

87. The law applicable to the contracts entered into by the project company with entities other than the host Government varies. Loan agreements will be often subject to the laws of a jurisdiction chosen by the parties. Agreements among the project sponsors may also be subject to

foreign law. In turn, the contracts between the project company and its local customers and users of the facility, or with its local employees, suppliers or other commercial partners, are often subject to the laws of the host country. It is important for the parties to consider carefully the enforceability in the host country of rights created or obligations assumed in other jurisdictions. At the same time, it might be advisable for the host Government to review pertinent provisions of national law in the light of the commitments that the project company is required to make for obtaining the financial and other means necessary for the implementation of the project.

XIII. SETTLEMENT OF DISPUTES

Notes

88. It is proposed to deal in a section with the legislative framework for the settlement of disputes that might arise in connection with a privately-financed infrastructure project.

89. Disputes between the project company and foreign contractors, or between the host Government and the project company, are frequently of a commercial nature and it has often been agreed to subject those disputes to arbitration. An appropriate legal framework for the settlement of those disputes may be provided by means of special legislation, based on internationally accepted standards, governing international commercial arbitration and reflecting particular needs of international arbitration. A particularly suitable model for such legislation is the UNCITRAL Model Law on International Commercial Arbitration.

90. It should be noted, however, that there might be limits to the availability of arbitration for disputes between the project company and the host Government under some legal systems, such as in those countries where disputes involving the Government come mandatorily under the jurisdiction of the national courts.

91. In view of the potentially large and complex disputes that may arise out of a privately-financed infrastructure project, it might be desirable for the law to enable the parties to devise mechanisms for dealing with divergencies as they arise and for avoiding their escalation into open litigation. In some cases, the parties found it useful to establish expert panels, with varying composition according to the nature of the issues at stake, which make recommendations to the parties for the settlement of their disputes. The implementation of the project might experience difficulties if even minor disagreements or disputes over technical issues needed to be submitted to lengthy proceedings for lack of an express legislative authorization for a mechanism to settle those disputes at an early stage.

92. Another category of disputes which may be of concern for the host Government are the disputes between the project company and its customers. The project company may be authorized, or in some cases required, to establish dispute settlement mechanisms. The extent to which such mechanisms may displace the jurisdiction of national courts depends on the laws of each country.

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